

REGULATORY COMMISSION STRUCTURE AND INDEPENDENCE ISSUES

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Institute of Public Utilities

- ▶ The mission of the Institute of Public Utilities is to support informed, effective, and efficient regulation of utility network industries—electricity, natural gas, water, and telecommunications.
- ▶ Emphasis on providing integrative and balanced educational programs and interdisciplinary research.
- ▶ The Institute is the educational arm of the National Association of Regulatory Utility Commissioners (NARUC)
- ▶ Established at Michigan State University in 1965 by Professor Harry Trebing
- ▶ Affiliated with the Law, Communications, and Business Schools
- ▶ Entirely self-supported through contributions and program revenues

Emergence of regulation as proxy or surrogate



Regulation substitutes for competition

- ▶ The key rationale for economic regulation is market failure—specifically, the tendency toward monopoly and the potential abuse of market power.
- ▶ Other types of market failure also lend support for regulation (including non-economic rationales)
- ▶ Regulation has long been considered an *imperfect* substitute for competition, particularly with regard to efficiency goals
- ▶ Regulation has to be a “tough” substitute (Trebing)
- ▶ Either competition or government must “regulate” the market: a noncompetitive/unregulated monopoly is not a socially acceptable option

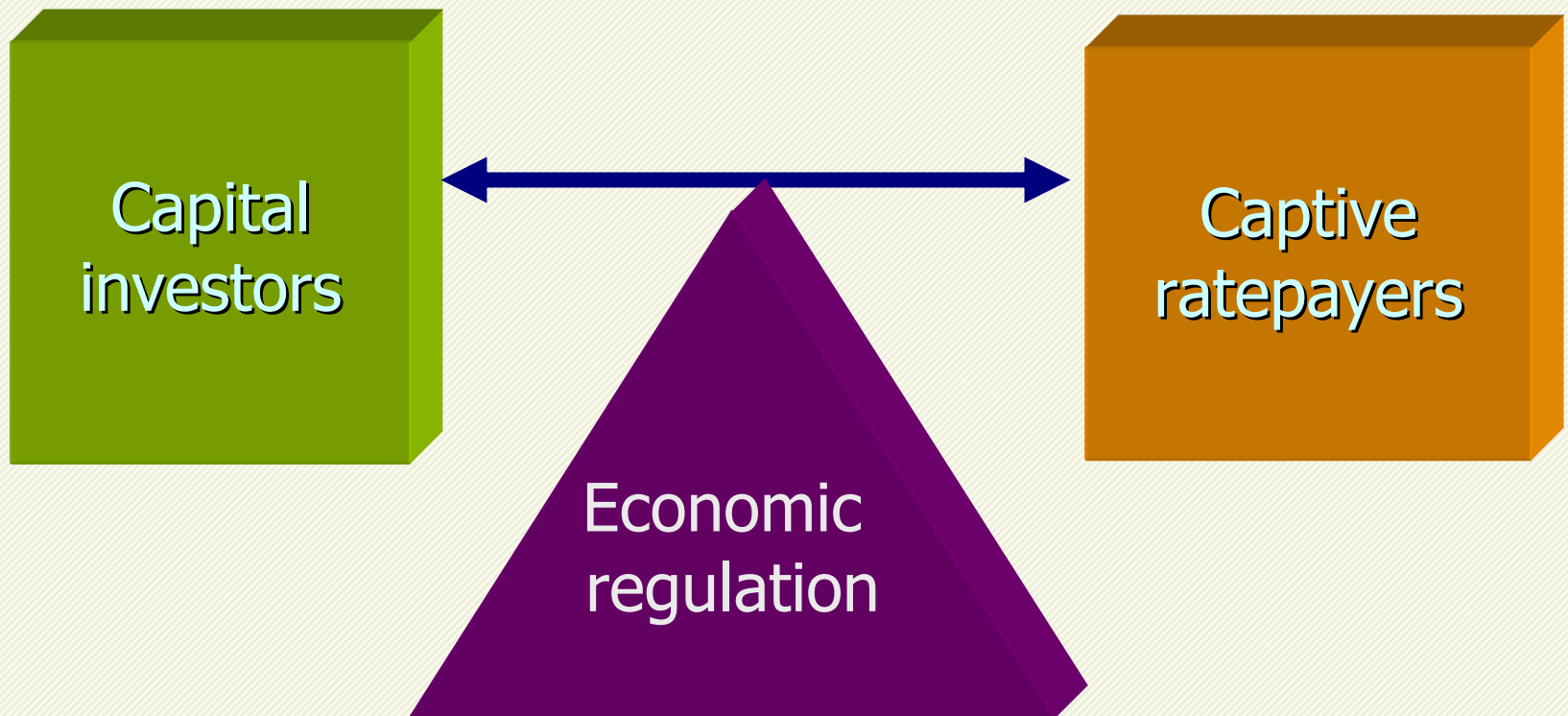
Imperfect substitute (continued)

- ▶ Regulation may be superior to competition in terms of criteria other than efficiency (e.g., social and environmental goals)
- ▶ Regulation should be operationally superior to public ownership in terms of investment, pricing, efficiency, and cross-subsidies (politicization)
- ▶ Regulation should be institutionally superior to legislative ratemaking or judicial proceedings
- ▶ Regulators do not need perfect information to do a good job (i.e., structuring incentives)
- ▶ In reality, imperfect competition is combined with imperfect regulation (Kahn)
- ▶ Regulation is the worst form of oversight, except for all others (apologies to Churchill)

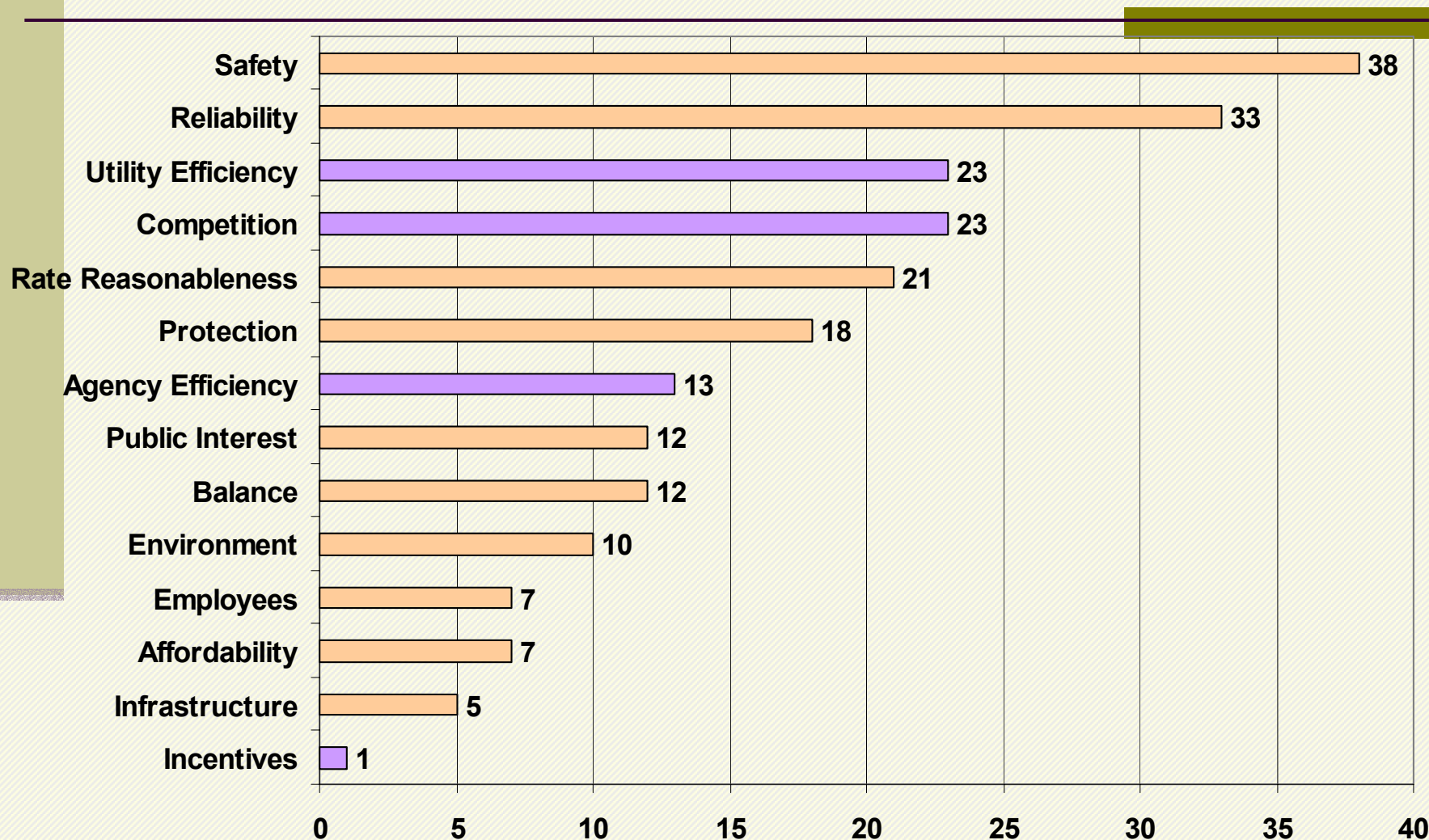
Regulation as balancing act

- ▶ Regulation “*in the public interest*” balances the interests of ratepayers with those of investors
 - Regulation provides the protection that captive ratepayers need: *captive customers lack choices*
 - Regulation provides the stability that infrastructure investors need: *investors want fair treatment*
- ▶ Regulators are “in the middle”

The balancing act



Commission mission statements



Montana

- ▶ The mission of the Public Service Commission is to fairly balance the long-term interests of Montana utility and transportation companies and the customers they serve.
- ▶ *The PSC's Role.* It is the responsibility of the PSC to ensure that public utilities in Montana provide adequate service to customers at reasonable rates. In its decisions, the commission tries to balance the interests of ratepayers who are concerned about utility costs with the utilities' need to have the opportunity to earn a fair rate of return on their investment. Public utility rate regulation can be complex because the utility business is complex. As long as utility service is provided by private monopolies, however, the public interest must be protected through regulation.

Florida

- ▶ Customers are served best by markets that facilitate the efficient provision of safe and reliable utility services at fair prices. **The mission of the Florida Public Service Commission is to promote the development of competitive markets—as directed by state and federal law—by removing regulatory barriers to competition, and by emphasizing incentive-based approaches, where feasible, to regulate areas that remain subject to rate of return regulation. Once markets become sufficiently competitive, the Florida Public Service Commission will eliminate regulatory involvement to the extent permitted by law.**

More acts of balancing in regulation

- ▶ Adequate investment and prudent investment
- ▶ Timely cost recovery and appropriate oversight
- ▶ Economic efficiency and social equity
- ▶ Market success and market failure
- ▶ Customer choice and the obligation to serve
- ▶ Performance incentives and accountability

A simple transitional model of regulation

- ▶ Regulators *have always and will always*
 - Set **standards** for market and utility performance
 - Hold utilities **accountable** for performance
 - Provide utilities with **incentives** for performance
- ▶ Regulation is a *means* of achieving policy goals:
 - Efficiency
 - Equity
 - Other goals
- ▶ Regulation and markets (or market mechanisms) can and will *co-exist* (managed or structured competition)

Commission structure

- ▶ Evolved from 20th century railroad commissions
- ▶ Constitutional or executive, legislative, or independent agencies
- ▶ Commission structures reflect functional responsibilities
- ▶ Most commissions regulate multiple sectors
 - Electricity, natural gas, telecommunications, water
- ▶ All have a professional staff, with variations in organization
- ▶ State-by-state variations in
 - Jurisdiction (who is regulated)
 - Authority (what is regulated)
 - Methods (how we regulate)
- ▶ Jurisdiction is shared with the federal government
 - FERC for energy
 - FCC for telecommunications
 - No federal economic regulation of water

Commission functions (traditional)

- ▶ Review and approve rates and charges
- ▶ Control market entry and exit
- ▶ Certify additions and expansion
- ▶ Impose a system of accounts
- ▶ Require annual financial reports
- ▶ Approve financial issuances
- ▶ Approve mergers and acquisitions
- ▶ Conduct financial audits
- ▶ Conduct management audits
- ▶ Specify standards and terms of service
- ▶ Resolve customer complaints
- ▶ Require planning and forecasting

Commission functions (new)

- ▶ Establish utility performance standards and market rules
- ▶ Monitor markets, enforce rules, and resolve disputes
- ▶ Evaluate utility performance
- ▶ Promote workable competition
- ▶ Allocate structural transition costs
- ▶ Provide dispute resolution and settlement processes
- ▶ Assess diversification (regulated/nonregulated)
- ▶ Advance consumer rights and protection
- ▶ Help ensure universal service
- ▶ Address environmental resource and siting concerns
- ▶ Manage modern information flows
- ▶ Maintain security policies
- ▶ Respond to federal initiatives
- ▶ Coordinate with other regulators (regional, national)

Core commission roles

▶ Quasi-judicial

- Making decisions like a court (deliberative)
- Legal procedures (openness, due process, ex parte rules)

▶ Quasi-administrative

- Making rules like a bureaucratic agency
- Administrative procedures and implementation

▶ Quasi-legislative

- Making policy like a legislature
- Active v. reactive models

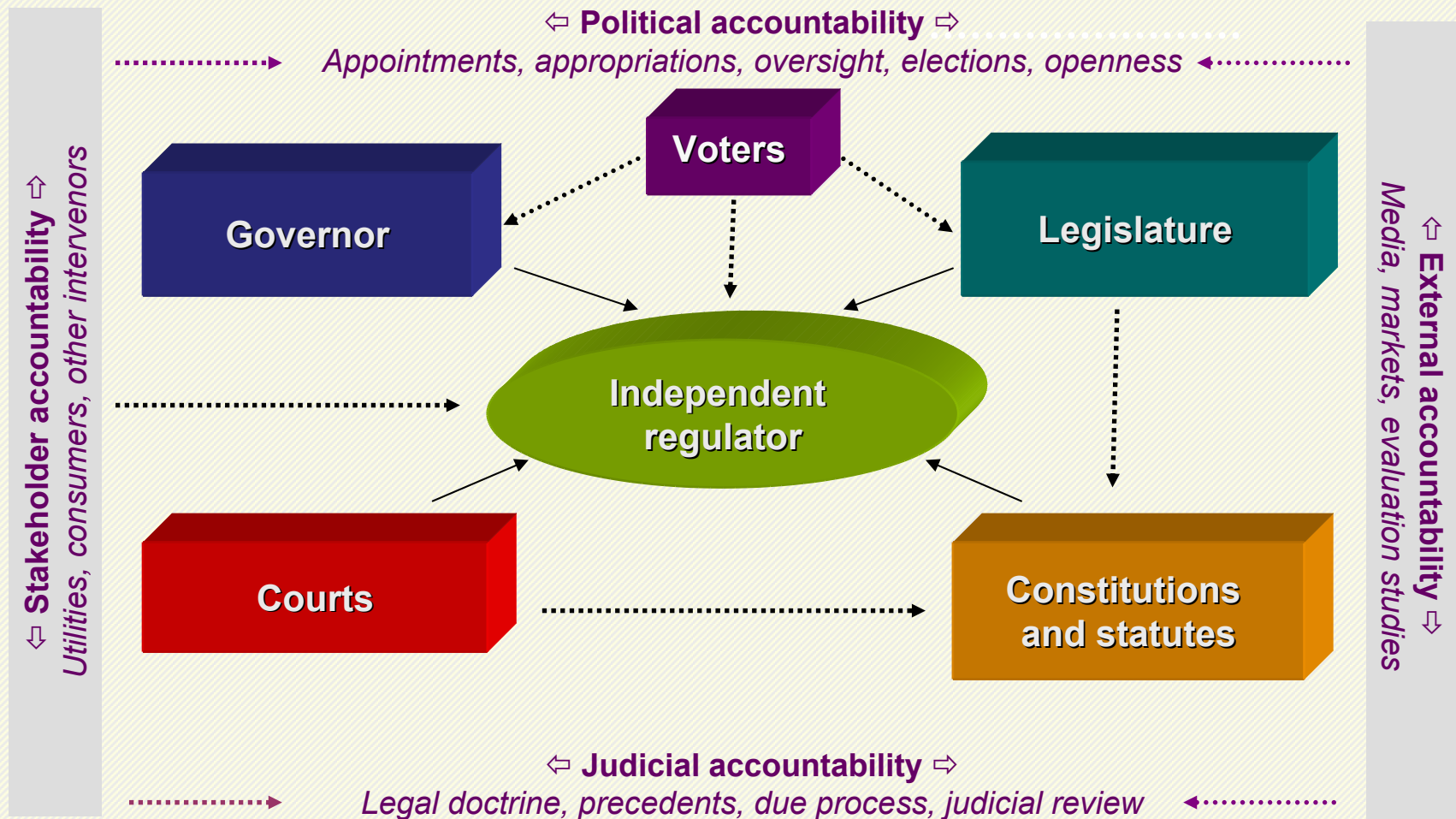
Structural complexity of the commissions

| Theory | Role | Types of issues | Organizational model | Procedural emphasis | Orientation |
|-----------------------------|------------------------|---------------------------------|----------------------|---------------------|-------------|
| Quasi-judicial | Impartial adjudication | Rates, prudence, disputes | Deliberative | Reactive | Process |
| Quasi-administrative | Policy Implementation | Reports, complaints, outreach | Bureaucratic | Rules and routines | Outputs |
| Quasi-legislative | Policy formulation | Planning, restructuring, equity | Political/policy | Proactive | Outcomes |

Regulator independence

- ▶ Differing perspectives on political independence
 - Need for better integration for policy (less independence)
 - Capture theory of regulation (more independence)
- ▶ According to the public-interest model, regulators are expected to be relatively independent from
 - Executives (presidents and governors)
 - Legislatures (legislative regulation)
 - Political parties (balanced representation)
 - Interest groups (no lobbying)
 - Utility companies (procedural protections)
- ▶ Regulator independence and accountability go hand in hand

Bounded independence of regulators



Mechanisms of commission oversight

▶ **Governmental**

- Political accountability
 - Commissioner elections
 - Governor (appointments, appropriations, orders, intervention)
 - Legislature (appointments, appropriations, statutes, rules)
 - Transparency (open meetings, records, and reports)
- Judicial accountability
 - Constitutional and legislative policy
 - Judicial review by the courts

▶ **Nongovernmental**

- Stakeholder accountability
 - Utility companies (including competitors)
 - Consumer advocates (residential and other)
 - Other intervenors (e.g., environmental interests)
- External accountability
 - Media (e.g., local papers; enhanced by openness)
 - Financial markets (Wall Street)
 - Evaluation studies

Commissioners

- ▶ Three to five members; turnover can be significant
- ▶ Terms of office vary
- ▶ Most appointed, some elected to fixed terms
- ▶ Some states have statutory qualifications or traditions (e.g., business, labor, or consumer seats)
- ▶ Partisan representation may be specified
- ▶ Divided about equally by party (R,D,I)
- ▶ Constraints on communications in many states
- ▶ Restrictions upon leaving commission
- ▶ Law is the dominant profession

Elected commissions

- ▶ Alabama
- ▶ Arizona
- ▶ Georgia
- ▶ Louisiana
- ▶ Mississippi
- ▶ Montana
- ▶ New Mexico
- ▶ Oklahoma
- ▶ South Carolina (legislature)
- ▶ South Dakota
- ▶ Texas (RR)
- ▶ Virginia (legislature)

Elected commission issues

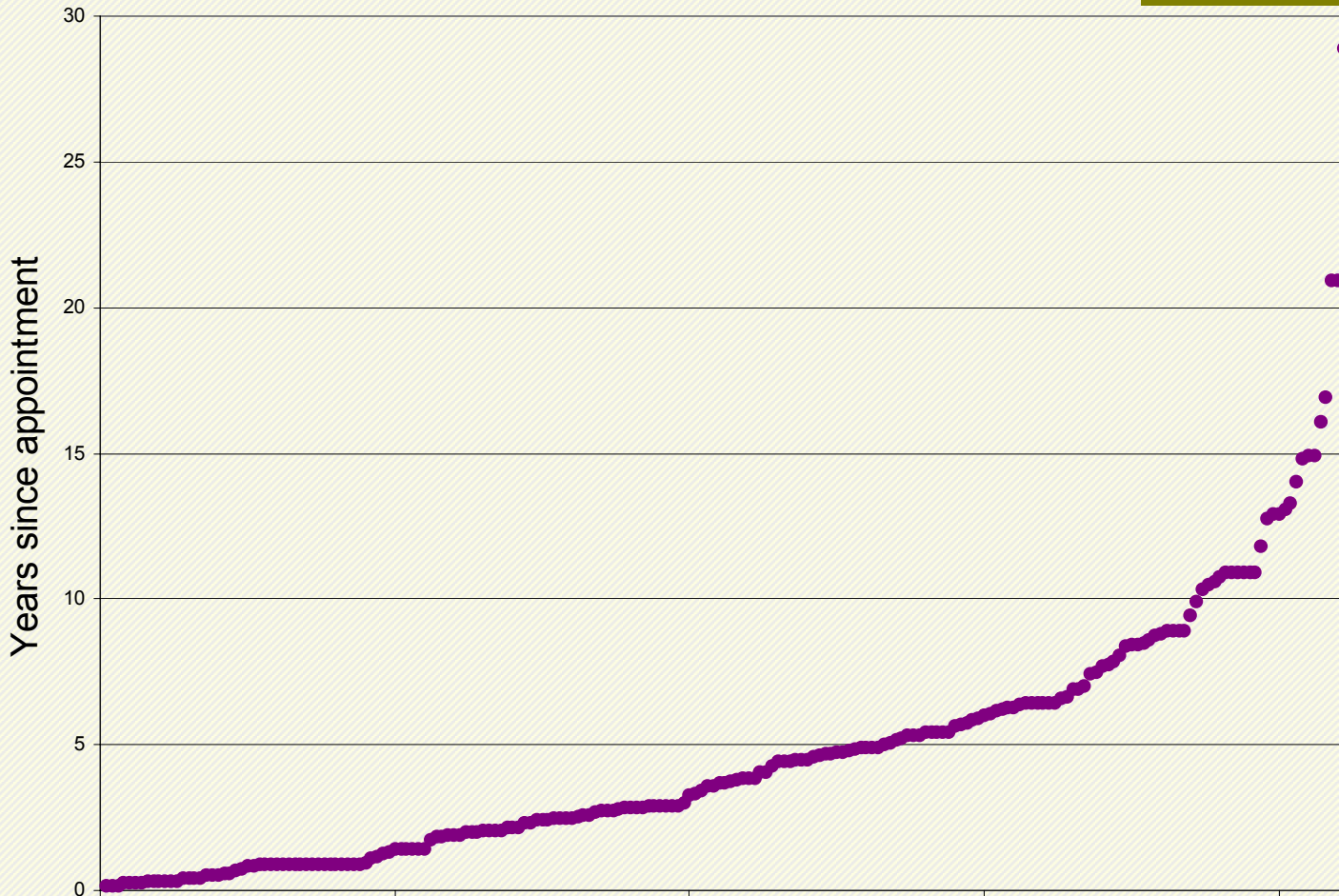
- ▶ Possible negative
 - Commissioner qualifications and diversity
 - Campaign financing (cost, contributor interests)
 - Electorate understanding of substance
 - Voter/consumer favoritism
- ▶ Possible positive
 - Democratizes and broadens candidate pool
 - More transparent to the public
 - Direct accountability to the electorate
 - Political independence (parties, governors)
- ▶ Few empirical studies
 - Off-limits research subject
 - Depends on quality of individual regulators
 - Other variables may have great influence on outcomes

Elected v. appointed

- ▶ Traditional model favors appointment
 - Commissioner qualifications
 - Professionalism
 - Political independence
- ▶ Recent experience
 - Politicization of appointment process
 - Possibly less independent
 - All commissioners “campaign” for the job
- ▶ Some possible safeguards
 - Endorsement (e.g., ABA) of qualified candidates
 - Term limits (mixed reviews here)
 - Effective oversight processes

Tenure of commissioners

In 2003, average years of service is 4.8 (median = 3.7 years)
as compared to 5.5 years in 1995 (median = 3.8 years)



Commission staff

- ▶ Staff roles (different people at different times)
 - *Advocates* appearing before the commission and representing the public interest (long term, societal); *ex parte* rules apply to these
 - *Administrators* that implement policy
 - *Advisors* in policy formulation
- ▶ Staff independence
 - Independence of staff from commission (and vice versa)
 - Redress the resource imbalance favoring utilities
 - Staff as “first among equals” in proceedings
 - Organizational and separation issues
 - Mutual frustrations--commissioners and staff
 - Signaling intentions from the bench
 - The long-run value of independent staff

Organizational structure

| | | | |
|--------------------------------|---|-------------------|---|
| Chair and Commissioners | | | |
| Commissioner assistants | | | |
| ↑ Dotted arrow pointing up | Executive Director | | General Counsel |
| | Administrative law judges/hearing examiners | | |
| | Technical/analytical staff | | Advocacy Staff (PUC or other agency) |
| | <i>Energy</i> | <i>Telecom</i> | <i>Water</i> |
| | Accounting and finance | Engineering | Economics and policy |
| | Support staff | | |
| | Information technologies | Consumer services | Clerical |

Strategic issues for commissions

- ▶ Constraints on governmental financial resources
- ▶ Commission structural, capacity, staffing, and efficiency issues
- ▶ Impacts of federal policy on jurisdiction (preemption) and workload
- ▶ Imperfect markets (oligopoly), monitoring, and dispute resolution
- ▶ Outcomes associated with restructuring (e.g., equity, bankruptcy)
- ▶ Ongoing transitional issues (e.g., price caps ending)
- ▶ Rising number and complexity of complaints
- ▶ Regional coordination and regulation
- ▶ Public benefits (environmental and consumer)
- ▶ Utility ownership, globalization, and corporate governance
- ▶ Asset protection (i.e., ring fencing) and bankruptcy impacts
- ▶ Need to educate the public, governor, and legislature

Commission performance (a sample)

- ▶ Process measures (deliberative)
 - Timeliness of decisions (regulatory lag)
 - Information technology adoption (electronic filing)
 - Dispute resolution
- ▶ Output measures (bureaucratic)
 - Complaints processed
 - Audits performed
 - Agency budget indicators
- ▶ Outcome measures (policy--hardest to measure)
 - Societal benefits relative to costs
 - Utility rate stability and affordability
 - Financial performance
 - Infrastructure investment
 - Environmental protection

Challenges for modern commissions

- ▶ (Re)build regulatory capacity
 - Invest in traditional skills
 - Invest in developing new skills
- ▶ Evaluate commission performance
 - Process, outputs, outcomes
 - Ability to provide standards, accountability, incentives
- ▶ Be cautious but open to change
 - Approach reform experimentally
 - Make adjustments as needed

INSTITUTE OF PUBLIC UTILITIES

INSTRUCTION - INTERACTION - INFORMATION - IDEAS



The Institute of Public Utilities is committed to a mission of supporting informed, effective, and efficient utility regulation by providing integrative, interdisciplinary, and balanced educational programs and applied research to the regulatory policy community. Our Annual Regulatory Studies Program (Camp NARUC) is recognized by the National Association of Regulatory Utility Commissioners and we host NARUC's Utility Rate Schools.

The Institute was established in 1965 as a not-for-profit, independent educational and research organization at [Michigan State University](#). Located on MSU's beautiful East Lansing campus, the Institute is affiliated with the College of Communication Arts & Sciences and the MSU-Detroit College of Law.

The Institute provides unique education and research programs designed specifically for the needs of the utility regulatory policy community.

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UPCOMING EVENTS

| What | Where | When | Info | Register |
|--|----------------------------|-------------------|---|---|
| The Eastern NARUC Utility Rate School: Basics of Rate Setting Sponsored by the NARUC Water Committee | Clearwater Beach, Florida | Sept. 21-26, 2003 | INFORMATION SCHEDULE BROCHURE FACULTY | ONLINE REGISTRATION |
| Consumer Services Training Program | Location TBA | Oct. 2003 | INFORMATION Available Soon | REGISTRATION Call |
| The New Balancing Act: Reconciling Markets and Regulation IPU's 35th Annual Regulatory Policy Conference | Charleston, South Carolina | Dec. 7-10, 2003 | INFORMATION AGENDA BROCHURE | ONLINE REGISTRATION |

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